

ASSEMBLY BILL

No. 1178

Introduced by Assembly Member Block

February 27, 2009

An act to amend Section 25110 of the Revenue and Taxation Code, relating to taxation, to take effect immediately, tax levy.

LEGISLATIVE COUNSEL'S DIGEST

AB 1178, as introduced, Block. Corporation tax: water's edge election: tax havens.

The Corporation Tax Law imposes taxes measured by income and, in the case of a business with income derived from or attributable to sources both within and without this state, apportions the income between this state and other states and foreign countries in accordance with a specified apportionment formula based on the property, payroll, and sales within and without this state, except as otherwise provided. That law allows corporations to elect whether their income is determined on a water's-edge basis or on a worldwide unitary basis. In general, a corporation that makes a water's-edge election is subject to tax on income only from sources within the United States but is required to take into account the income and apportionment factors of certain specified affiliated entities.

This bill would expand the list of specified affiliated entities for taxable years beginning on or after January 1, 2010, to include a corporation that is incorporated, headquartered, or located in a country that is a tax haven, as defined, and would make related legislative findings and declarations.

This bill would also require the Legislative Analyst, in consultation with the Franchise Tax Board, to conduct a study regarding the

jurisdictions identified by the Organization for Economic Cooperation and Development (OECD) as tax havens and to report to the Legislature, no later than January 1, 2011, as to whether the definition of the term “tax haven” should be revised.

This bill would result in a change in state taxes for the purpose of increasing state revenues within the meaning of Section 3 of Article XIII A of the California Constitution, and thus would require for passage the approval of $\frac{2}{3}$ of the membership of each house of the Legislature.

This bill would take effect immediately as a tax levy.

Vote: $\frac{2}{3}$. Appropriation: no. Fiscal committee: yes.

State-mandated local program: no.

The people of the State of California do enact as follows:

1 SECTION 1. (a) The Legislature finds and declares all of the
2 following:

3 (1) The sheltering of income in offshore tax haven countries
4 has been a major means of tax avoidance for multinational
5 corporations.

6 (2) In many cases the sheltering occurs because income that
7 should be properly attributed to activities in the United States is
8 being attributed to those tax haven countries.

9 (3) The water’s-edge election provisions enacted by California
10 addressed these concerns by requiring that some foreign
11 incorporated entities be included within a corporate taxpayer’s
12 water’s-edge combined report. However, additional strategies have
13 been developed by multinational corporations to assign income to
14 foreign incorporated entities that perform limited economic activity
15 in those countries and are not included within the water’s-edge
16 combined report.

17 (b) It is the intent of the Legislature, therefore, in enacting this
18 section, to further limit the ability of multinational corporations
19 to use tax haven countries to exclude income from the water’s-edge
20 combined report as a means of domestic tax avoidance, to the
21 extent that such income is not derived from, or attributable to,
22 substantial economic presence or significant economic activity in
23 the tax haven country.

24 (c) In granting regulatory authority to the Franchise Tax Board
25 with regard to a determination of whether a corporation has
26 established a substantial economic presence or conducts significant

economic activity in a tax haven country, the Legislature intends that the Franchise Tax Board examine whether economic factors, including payroll and property, are located in the tax haven in a manner proportionate to the income attributable to the tax haven.

SEC. 2. Section 25110 of the Revenue and Taxation Code, as added by Section 2 of Chapter 22 of the Statutes of 2006, is amended to read:

25110. (a) Notwithstanding Section 25101, a qualified taxpayer, as defined in paragraph (2) of subdivision (b), that is subject to the tax imposed under this part, may elect to determine its income derived from or attributable to sources within this state pursuant to a water's-edge election in accordance with the provisions of this part, as modified by this article. A taxpayer, that makes a water's-edge election on or after January 1, 2006, shall take into account that portion of its own income and apportionment factors and the income and apportionment factors of its affiliated entities to the extent provided below:

(1) The entire income and apportionment factors of any of the following corporations:

(A) Domestic international sales corporations, as described in Sections 991 to 994, inclusive, of the Internal Revenue Code and foreign sales corporations as described in Sections 921 to 927, inclusive, of the Internal Revenue Code.

(B) Any corporation (other than a bank), regardless of the place where it is incorporated if the average of its property, payroll, and sales factors within the United States is 20 percent or more.

(C) Corporations that are incorporated in the United States, excluding corporations making an election pursuant to Sections 931 to 936, inclusive, of the Internal Revenue Code.

(D) Export trade corporations, as described in Sections 970 to 972, inclusive, of the Internal Revenue Code.

(E) (i) *Subject to clause (ii), for taxable years beginning on or after January 1, 2010, any corporation that, for any portion of the taxable year, was doing business in, or had income derived from or attributable to, a tax haven.*

(ii) *If the application of clause (i) results in the inclusion of a business activity in, or income derived from or attributable to, a tax haven that constitutes either a substantial economic presence or significant economic activity in that jurisdiction, the taxpayer may petition the Franchise Tax Board to treat the activity and*

1 *income of that corporation or activity as not having been conducted*
2 *in, or derived from or attributable to, the tax haven.*

3 (iii) *The Franchise Tax Board shall prescribe any regulations*
4 *that may be necessary or appropriate to carry out the purposes of*
5 *the amendments made to this section by the act adding this clause,*
6 *including regulations prescribing the extent to which an activity*
7 *in, or income derived from or attributable to, a tax haven will be*
8 *presumed to be either a substantial economic presence or*
9 *significant economic activity, and the extent to which income will*
10 *be presumed to be not derived from or attributable to a tax haven.*

11 (2) (A) With respect to a corporation that is not described in
12 subparagraphs (A), (B), (C), and (D) of paragraph (1), as provided
13 in either one or both of the following clauses:

14 (i) The income and apportionment factors of that corporation
15 to the extent of its income derived from or attributable to sources
16 within the United States and its factors assignable to a location
17 within the United States in accordance with paragraph (3) of
18 subdivision (b). Income of that corporation derived from or
19 attributable to sources within the United States as determined by
20 federal income tax laws shall be limited to, and determined from,
21 the books of account maintained by the corporation with respect
22 to its activities conducted within the United States.

23 (ii) The income and apportionment factors of that corporation
24 that is a “controlled foreign corporation,” as defined in Section
25 957 of the Internal Revenue Code, to the extent determined by
26 multiplying the income and apportionment factors of that
27 corporation without application of this subparagraph by a fraction
28 not to exceed one, the numerator of which is the “Subpart F
29 income” of that corporation for that taxable year and the
30 denominator of which is the “earnings and profits” of that
31 corporation for that taxable year.

32 (B) For purposes of this paragraph, both of the following apply:

33 (i) “Subpart F income” means “Subpart F income” as defined
34 in Section 952 of the Internal Revenue Code.

35 (ii) “Earnings and profits” means “earnings and profits” as
36 described in Section 964 of the Internal Revenue Code.

37 (3) The income and apportionment factors of the corporations
38 described in this subdivision shall be taken into account only to
39 the extent that they would have been taken into account had no
40 election under this section been made.

1 (4) The Franchise Tax Board shall prescribe regulations to
2 coordinate implementation of subparagraph (A) of paragraph (2)
3 to prevent multiple inclusion or exclusion of income and factors
4 in situations where the same item of income is described in both
5 clauses.

6 (b) For purposes of this article and Section 24411, all of the
7 following definitions apply:

8 (1) An “affiliated corporation” means a corporation that is a
9 member of a commonly controlled group as defined in Section
10 25105.

11 (2) A “qualified taxpayer” means a corporation that does both
12 of the following:

13 (A) Files with the state tax return, on which the water’s-edge
14 election is made, a consent to the taking of depositions, at the time
15 and place most reasonably convenient to all parties, from key
16 domestic corporate individuals and to the acceptance of subpoenas
17 duces tecum requiring reasonable production of documents to the
18 Franchise Tax Board, as provided in Section 19504, by the State
19 Board of Equalization, as provided in Section 5005 of Title 18 of
20 the California Code of Regulations, or by the courts of this state,
21 as provided in Chapter 2 (commencing with Section 1985) of Title
22 3 of Part 4 of, and Chapter 9 (commencing with Section 2025.010)
23 of Title 4 of Part 4 of, the Code of Civil Procedure. The consent
24 relates to issues of jurisdiction and service and does not waive any
25 defenses that a taxpayer may otherwise have. The consent shall
26 remain in effect as long as the water’s-edge election is in effect,
27 and shall be limited to providing that information necessary to
28 review or adjust income or deductions in a manner authorized by
29 Section 482, 861, Subpart F of Part III of Subchapter N, or similar
30 provisions, of the Internal Revenue Code, together with the
31 regulations adopted pursuant to those provisions, and for the
32 conduct of an investigation with respect to any unitary business
33 in which the taxpayer may be involved.

34 (B) Agrees that, for purposes of this article, dividends received
35 by any corporation whose income and apportionment factors are
36 taken into account pursuant to subdivision (a) from either of the
37 following are functionally related dividends and shall be presumed
38 to be business income:

1 (i) A corporation of which more than 50 percent of the voting
2 stock is owned, directly or indirectly, by members of the unitary
3 group and which is engaged in the same general line of business.

4 (ii) Any corporation that is either a significant source of supply
5 for the unitary business or a significant purchaser of the output of
6 the unitary business, or that sells a significant part of its output or
7 obtains a significant part of its raw materials or input from the
8 unitary business. “Significant,” as used in this subparagraph, means
9 an amount of 15 percent or more of either input or output.

10 All other dividends shall be classified as business or nonbusiness
11 income without regard to this subparagraph.

12 (3) The definitions and locations of property, payroll, and sales
13 shall be determined under the laws and regulations that set forth
14 the apportionment formulas used by the individual states to assign
15 net income subject to taxes on, or measured by, net income in that
16 state. If a state does not impose a tax on, or measured by, net
17 income or does not have laws or regulations with respect to the
18 assignment of property, payroll, and sales, the laws and regulations
19 provided in Article 2 (commencing with Section 25120) shall
20 apply.

21 Sales shall be considered to be made to a state only if the
22 corporation making the sale may otherwise be subject to a tax on,
23 or measured by, net income under the Constitution or laws of the
24 United States, and shall not include sales made to a corporation
25 whose income and apportionment factors are taken into account
26 pursuant to subdivision (a) in determining the amount of income
27 of the taxpayer derived from or attributable to sources within this
28 state.

29 (4) “The United States” means the 50 states of the United States
30 and the District of Columbia.

31 (5) (A) *For purposes of this section, a “tax haven” means any*
32 *of the 39 jurisdictions that, as of December of 2002, were identified*
33 *as tax havens by the Organization for Economic Cooperation and*
34 *Development (OECD).*

35 (B) *The Franchise Tax Board shall issue a notice identifying*
36 *the jurisdictions that are tax havens for purposes of this section.*

37 (C) *The Legislative Analyst, in consultation with the Franchise*
38 *Tax Board, shall conduct a study regarding the jurisdictions*
39 *identified by the OECD as tax havens and shall report to the*

1 *Legislature, no later than January 1, 2011, as to whether the*
2 *definition of the term “tax haven” should be revised.*

3 (c) All references in this part to income determined pursuant to
4 Section 25101 shall also mean income determined pursuant to this
5 section.

6 SEC. 3. This act provides for a tax levy within the meaning of
7 Article IV of the Constitution and shall go into immediate effect.

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